

STATE BOARD OF ACCOUNTS
302 West Washington Street
Room E418
INDIANAPOLIS, INDIANA 46204-2765

REVIEW REPORT
OF
INDIANA DEPARTMENT OF REVENUE
STATE OF INDIANA
July 1, 2004 to June 30, 2005

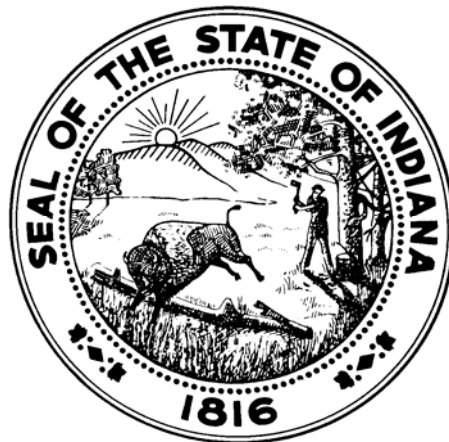


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AGENCY OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Commissioner	Kenneth L. Miller Tom Obsitnik John Eckart	01-09-01 to 01-09-05 01-10-05 to 02-21-05 02-22-05 to 01-11-09



STATE OF INDIANA

AN EQUAL OPPORTUNITY EMPLOYER

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INDEPENDENT ACCOUNTANT'S REPORT

TO: THE OFFICIALS OF INDIANA DEPARTMENT OF REVENUE

We have reviewed the receipts, disbursements, and assets of the Indiana Department of Revenue for the period of July 1, 2004 to June 30, 2005. Indiana Department of Revenue's management is responsible for the receipts, disbursements, and assets.

Our review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review is substantially less in scope than an examination, the objective of which is the expression of an opinion on the receipts, disbursements, and assets. Accordingly, we do not express such an opinion.

Financial transactions of this office are included in the scope of our audits of the State of Indiana as reflected in the Indiana Comprehensive Annual Financial Reports.

Based on our review, nothing came to our attention that caused us to believe that the receipts, disbursements, and assets of the Indiana Department of Revenue are not in all material respects in conformity with the criteria set forth in the Accounting and Uniform Compliance Guidelines Manual for State Agencies, and applicable laws and regulations except as stated in the review comments.

STATE BOARD OF ACCOUNTS

January 28, 2006

INDIANA DEPARTMENT OF REVENUE
REVIEW COMMENTS
June 30, 2005

LIABILITY INTEREST RATE

In November of each year, the Department of Revenue (Department) must determine the tax liability interest rate for the subsequent calendar year to be applied to outstanding delinquent taxes. The Department is required to use the average investment yield (rate) as published in the State's Comprehensive Annual Financial Report (CAFR) as a basis for their interest calculation. The calculated rate is printed on various tax forms and coupons and programmed into their returns processing system to become effective the following January 1.

During our review of the 2005 liability interest rate, we found that the Department did not apply the rate stated in the CAFR as a basis for their calculation. For calendar year 2005, the Department calculated a 3% interest rate on tax liabilities. However, the interest calculation is 4% when using the CAFR rate.

By using a rate of 3% instead of 4%, the Department will collect less interest than required. This error has long-term effects. It will reduce the amount of 2005 assessed interest that the Department will collect on liability payments received in 2005. The Department will also collect less interest on unpaid liabilities incurred prior to 2005 that will be collected in future years. Therefore, the amount of lost interest to the state was not determinable.

Indiana Code 6-8.1-10-1(c) states, in part, that: "The commissioner shall establish an adjusted rate of interest . . . the adjusted rate of interest shall be the percentage rounded to the nearest whole number that equals two (2) percentage points above the average investment yield on state money for the state's previous fiscal year, excluding pension fund investments, as published in the auditor of state's comprehensive annual financial report. . . ."

LOIT DISTRIBUTIONS

Local Option Income Taxes (LOIT) are established by local ordinances and paid by taxpayers through county income tax calculations on state individual income tax returns. The Department processes those tax returns and sends related data to the State Budget Agency. Yearly, the Budget Agency certifies to the Department the amounts to be paid to each county and the Department's Controllers Division makes monthly, bi-yearly, or yearly distributions of the certified amounts to the counties. LOIT includes COIT (County Option Income Tax), CAGIT (County Adjusted Gross Income Tax), and CEDIT (County Economic Development Income Tax).

During our review of LOIT distributions, we found that the Division made errors on two distributions by not using the certified amounts. On the November 2004 CEDIT distribution, there was a net overpayment of \$6,274,407.96 to the counties and, on the May 2005 CEDIT Homestead Credit distribution, a net underpayment of \$5,035,307.46. Within days of the distributions, the errors were noted by the Auditor of State in one instance and the Budget Agency in the other. Upon notification, the Division corrected the errors.

The LOIT certified amounts for distribution to the counties should be a cooperative effort between the Department and Budget Agency. These errors occurred due to a lack of adequate internal controls within the Division and between agencies. There are no written policies or procedures detailing the assignment of responsibilities and oversight of each agency for sufficient verification and proper distribution of certified LOIT amounts.

INDIANA DEPARTMENT OF REVENUE
REVIEW COMMENTS
June 30, 2005
(Continued)

Each agency, department, institution or office should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets and all forms of information processing are part of an internal control system. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

SALES TAX COLLECTION ALLOWANCE

Merchants (taxpayers) who collect sales tax at point of sale must remit those collections to the Department monthly. Collections from one month are usually due by the 20th day of the following month. If sales tax payments are paid in full by the due date, taxpayers may keep a portion of the sales tax through a collection allowance. The allowance is based on a percentage of the taxpayers' total sales tax collections for the month.

In reviewing sales tax revenue, we found that the Department had given taxpayers a collection allowance even if only a partial payment of the prior month's collections was remitted. By giving an allowance to taxpayers who remit less than a full payment, the Department collected less in sales taxes than required.

Indiana Code 6-2.5-6-10(a) states: "In order to compensate retail merchants for collecting and timely remitting the state gross retail tax and the state use tax, every retail merchant . . . is entitled to deduct and retain from the amount of those taxes otherwise required to be remitted. . . ."

Each agency, department, institution or office should have internal controls in effect, which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

IRP PAYMENTS FROM OTHER STATES

Indiana is a party to the International Registration Plan (IRP) multi-state cooperative agreement. IRP fees are based on the number of miles commercial vehicles travel through each of the cooperative states. Commercial vehicles are registered in their home state and remit all fees to that state. Monthly, each state distributes to the other states a portion of fees collected. The Department receives fees from other states for commercial vehicles registered in other states that traveled through our state.

Upon receipt of payments received from other states, the Department allocates the fees into two state accounts. The percentage deposited into the Commercial Vehicle Excise Tax (CVET) account is determined by an annual rate calculated by the Department in accordance with Indiana Code 6-6-5.5-3. The remaining fees are deposited into the Motor Vehicle Highway account.

We reviewed the out-of-state payments deposited by the Department and found that 80% of those payments reviewed were not properly allocated to each account. The Department used an incorrect method to allocate the funds causing one account to be over-funded and the other under-funded. Subsequent to our finding, the Department used the correct method to recalculate the allocation percentages of the two accounts and the adjusted amount to be transferred.

INDIANA DEPARTMENT OF REVENUE
REVIEW COMMENTS
June 30, 2005
(Continued)

The Department calculated the CVET account to be over-funded by \$2,014,377.51 and, as of January 28, 2006, was in the process of making the final evaluation on the transfer adjustment to correct the error. According to personnel at the Auditor of State, a CVET account adjustment made by the Department, on a per county basis, will not have a significant financial impact on their future distributions.

Each agency, department, institution or office should have internal controls in effect, which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, all forms of information processing are part of an internal control system. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

LAKE COUNTY TAX CREDIT

The Lake County Residential Income Tax Credit allows qualifying taxpayers to claim a credit on their individual state income tax returns. The Department captures the total county credits each tax (calendar) year on their returns processing system. These credits reduce the amount of riverboat admissions tax distributions given to Lake County and the three largest cities by population in the county. State distributions are made by the Auditor of State subsequent to receiving the tax credit information.

During our review, we found that, although the credit became effective on January 1, 2001, the Department had not forwarded the tax credit totals for calendar years 2001, 2002, 2003, and 2004 to the Auditor of State until June 2005. As a result, the amount of riverboat admissions tax distributions for those corresponding years was not reduced as required. Public Law 246-2005, Section 246, recognized this oversight and required a catch-up reduction of distributions be made in 2005, 2006, and 2007.

Each agency, department, institution or office should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

MONITORING OF DISTRICT OFFICES

As stated in our prior Audit Report B24294, a majority of the district offices did not submit monthly Certification of Funds Accounting System to the Audit Division by the fifth day of the following operational month as required in the Audit Division District Office Procedures.

Each agency, department, institution or office also has the responsibility to comply with their own internal policies and guidelines. These internal policies and guidelines cannot conflict with state or federal laws, state policies or procedures (including those in this manual) or other policies established by Department of Administration, Department of Personnel or through the Financial Management Circulars. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

INDIANA DEPARTMENT OF REVENUE
REVIEW COMMENTS
June 30, 2005
(Continued)

AGENCY COLLECTION SERVICE CONTRACTS

As stated in our prior Audit Report B24294, the Department has been paying for agency collection services without a valid contract since July 1, 2004.

Each agency is responsible for compliance with applicable statutes, regulations, contract provisions, state policies, and federal requirements. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

WITHHOLDING RECONCILIATION

As stated in our prior reports (most recently B24294 and B22493), the Department's internal controls over the reconciliation of income tax withholding did not guarantee that adequate compliance was being maintained. Controls are still not adequate and may allow discrepancies to go undetected.

Controls over the receipting, disbursing, recording, and accounting for the financial activities are necessary to avoid substantial risk of invalid transactions, inaccurate records and financial statements, and incorrect decision making. An agency's control environment consists of the overall attitude, awareness and actions of management and the governing board or commission. This would include establishing and monitoring policies for developing and modifying accounting systems and control procedures. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 3)

DAILY DEPOSITS

As stated in prior reports (most recently B24294 and B22493), the Department did not consistently deposit receipts collected for most tax remittance types within the following business day.

Indiana Code 5-13-6-1(b) states in part: ". . . all public funds . . . shall be deposited with the treasurer of state, or an approved depository selected by the treasurer of state not later than the business day following the receipt of the funds."

INDIANA DEPARTMENT OF REVENUE
EXIT CONFERENCE

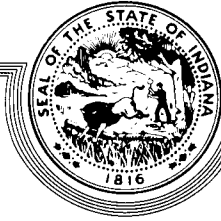
The contents of this report were discussed on March 21, 2006, with John Eckart, Commissioner. The official response has been made a part of this report and may be found on pages 9 through 11.

The contents of this report were mailed on March 22, 2006, to Kenneth L. Miller, former Commissioner.

The contents of this report were mailed on March 22, 2006, to Tom Obsitnik, Interim Commissioner.

STATE OF INDIANA

DEPARTMENT OF REVENUE
OFFICE OF THE COMMISSIONER
INDIANA GOVERNMENT CENTER NORTH
100 NORTH SENATE AVENUE, ROOM N248



INDIANAPOLIS, 46204-2253

April 3, 2006

Mr. Bruce Hartman, State Examiner
State Board of Accounts
Indiana Government Center South
302 W. Washington Street, E418
Indianapolis, IN 46204

Dear Mr. Hartman

Attached please find the Indiana Department of Revenue's official response to the 2005 Audit by the State Board of Accounts. If I can be of further assistance, please contact me at your convenience.

Sincerely

John Eckart
Commissioner

Enclosure

LIABILITY INTEREST RATE

Indiana Code 6-8.1-10-1(c) states "The commissioner shall establish an adjusted rate of interest for a failure described in subsection (a) and for an excess tax payment on or before November 1 of each year..." The adjusted rate of interest must be filed by October 15 for publication to occur on or before November 1. The Department was forced to rely upon an estimate of the actual rate provided by the Treasurer's office. The actual rate is published in the CAFR, after approval by the State Board of Accounts. That publication usually does not occur until after November 1. Therefore, under the circumstances, it is very difficult, if not impossible at times, to meet the deadline requirements. The estimated interest rate used by the Département proved to be in error when actual publication occurred.

LOIT DISTRIBUTIONS

The Department strives to work with other agencies and correct errors in a timely fashion. We corrected the LOIT errors noted in the Review Comments in a timely fashion. We will continue to verify distributions prior to dissemination. We have made a procedural change to review the distribution and match it to the certified spreadsheet before the distribution is released.

SALES TAX COLLECTION ALLOWANCE

The Department has revised procedures to ensure that only taxpayers who remit timely and pay in full their sales tax collections will receive the collection allowance.

IRP PAYMENTS FROM OTHER STATES

An incorrect rate was used for a few months and has been corrected. The Motor Carrier section has established additional oversight for the CVET allocation to ensure its accuracy.

LAKE COUNTY TAX CREDIT

The Department did not report to the Auditor's Office the amount of this credit for the first several years. The annual report has now been prepared and submitted.

MONITORING OF DISTRICT OFFICES

Currently the District Office Field Supervisor is responsible for certification of funds; reports are to be mailed into the Central Office. We will be training an additional person (which will bring the total to two) who will be responsible for auditing the funds certification statements and following up with any District Office that fails to file a timely report.

AGENCY COLLECTION SERVICE CONTRACTS

The Department's current short-term arrangement for agency collection services has received approval from Susan Gard, IDOA.

WITHHOLDING RECONCILIATION

The Department continues to review withholding accounts for validity. Statistical samplings of employers who file magnetic media are being conducted. Efforts to improve the PC-based program for downloading magnetic media are currently under development. Returns identified by the system to be reviewed by a user are examined; employer identification numbers are checked for validity and withholding registration.

Meanwhile, the Returns Processing System automatically verifies monthly withholding remittance to the annual withholding reconciliation return. If a discrepancy exists, the account is flagged for a user review.

DAILY DEPOSITS

Each year the Returns Processing Center strives to deposit funds within 24 hours of receipt. During the peak period in April, the Department receives approximately one million (1,000,000) returns. At such a time, it is humanly impossible to meet the 24-hour requirement. Furthermore, the costs would far outweigh the benefits of such an effort. Nevertheless, the Department will continue to use as many resources as operationally possible and fiscally responsible to meet the 24-hour deposit requirement.

03/19/06

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